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Russian Alcohol Market Regulation 2008-2010 Update

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Report Highlights:

Having one of the highest alcohol consumption rates in the world and one of the most effective illegal alcohol markets, the Russian government has been taking steps to moderate Russian drinking habits while at the same time establishing new mechanisms to capture alcohol tax revenue and cut down on illegal production. As part of that, the government has taken several steps in the past two years that impact how the GOR regulates alcohol. For example, a new agency responsible for regulating alcohol was established by presidential order on December 31, 2008, the Federal Service for the Regulation of Alcohol. Many of these recent changes affect imports of alcoholic beverages. For example, all imported alcoholic beverages now must obtain an import license. The legal, regulatory, and technical rules are extensive and change frequently. Most of them are still in the drafting phase and need to be carefully followed as they go into great detail to regulate and restrict sale and production of alcohol in Russia.

Governmental Framework

The Russian alcohol sector is regulated and controlled by at least four Government agencies, the Federal Service for the Regulation of the Alcohol Market (FSRAM), Customs, the Ministry of Industry and Trade, and the Federal Service for the Protection of Consumer Rights and Human Welfare of the Ministry of Health and Social Development. The most important of these is FSRAM. FSRAM was established by Russian President Dmitry Medvedev under Order #1883 on December 31, 2008 (the original Russian text of the Order can be found on the Russian President's official website at <http://document.kremlin.ru/doc.asp?ID=50076&PSC=1&PT=1&Page=1>). FSRAM took over alcohol regulatory functions from several government bodies, including the Ministries of Finance (MF), Agriculture, the Federal Taxation Service (FTS), and the Federal Service on Tariffs. According to the Presidential Order, the most important function of FSRAM lies in the sphere of control and legislative and normative regulation of the alcohol market. When it is fully up and running (FSRAM did not have an office until September 2009 and faced delays in hiring employees) the agency will have a huge staff of nearly 1000, where 300 persons will work for the head office (48 of which will come directly from Federal Taxation Service) and 642 officials in the regions excluding service and security personnel. FSRAM will consist of at least 9 departments. To date the staffing is reportedly sparse and the organization lacks transparency.

Shortly after FSRAM's creation, Russian Prime Minister Vladimir Putin signed decree #31-p on January 19, 2009 appointing Igor Chuyan to lead FSRAM (the original Russian text can be found on the Russian government's official website at: <http://government.ru/gov/results/6822/>). Mr. Chuyan is a former General Director of Rosspirtprom, a state-owned holding company still in operation that produced about 40 percent of all Russian pure alcohol and 16 percent of vodka and spirits products in 2008. According to the State Statistics Service, Rosspirtprom's Russian market share was 16 percent (\$19.9 million) in 2008. Insiders in the Russian alcohol market describe Mr. Chuyan as a qualified manager and professional.

The functions of FSRAM (Rosalcohol in Russian) are further defined in the Prime Minister's Resolution #154 of February 24, 2009 (the original text of the Resolution can be found on the Russian's government's official website at: <http://government.ru/gov/results/6690/>). On October 15, 2009 the GOR transferred (a) the function for licensing production and wholesale sales of alcohol and (b) management of the Unified Federal Automated Information System (UFAIS) from FTS to FSRAM. Thus, FSRAM regulates:

- Licensing of alcohol manufacturing and wholesale distribution
- Everything related to Federal Special Stamps (not to be confused with Excise Stamps which stick on imported alcohol and are sold by Customs).
- Everything related to UFAIS, including "modernization of software"
- Minimum prices for alcohol

FSRAM has taken a hard stance on licensing. About 60 Russian alcohol producers and 150 distributors lost their licenses in 2010.

Prime Minister Putin also signed Resolution #2 on January 8, 2009 to fully implement the United Federal Automated Information System (UFAIS) which tracks production and turnover of ethyl spirit,

alcohol, and spirit containing products. (The original Russian text of the Resolution can be found on the Russian government's official website at <http://government.ru/gov/results/6473/>.) After many failed rollout dates for the UFAIS, the Russian government replaced the old UFAIS software with the new one in June 2009. UFAIS implementation is a key milestone of the GOR's alcohol market reform which started in 2006. The goal of the UFAIS is to account for and control all distilled beverages in the Russian market and help the GOR collect all alcohol tax revenue.

While FSRAM has a broad range of responsibilities in regulating alcohol, the functions related to imported alcohol are limited to its sale within in Russia. The Ministry of Industry and Trade is responsible for alcohol import licenses, The Federal Customs Service sells Excise Stamps for importers.

Overseeing these activities is the Commission on Regulation of the Alcohol Market, created on October 29, 2009. The Commission functions as a coordination body among the Federal branch and of the executive power as well as those of the Russian regional authorities in regulating the alcohol market, particularly in:

- effectively regulating production and turnover of alcohol;
- expanding measures to fight illegal production of alcohol;
- preparing legislative and regulative acts related to production and turnover of alcohol.

So, for example, Commission members – who come from different Ministries and Federal Services (including FSRAM) – approve minimum prices and draft measures such as the Measure to Increase the Effectiveness of Regulation of Alcohol and Ethyl Spirit Production in the Russian Federation” which then goes to the Prime Minister for signature.

(For details please see Prime Minister's Resolution #856 and Decree # 1579-p on the Russian's government's official website at: <http://government.ru/gov/results/8044/> and <http://government.ru/gov/results/8047/>).

It is also important to note that the Commission will be dealing with issues of the beer industry, even though beer is currently not formally regulated as an alcoholic product.

The Commission is chaired by First Deputy Prime Minister, Mr. Zubkov, and consists of 15 high-ranking RF officials, including FSRAM's Mr. Chuyan who acts as Deputy Chairman of the Commission, Rospotrebnadzor's Mr. Onischenko, MF's Mr. Shatalov, MED's Mrs. Popova, FTS's Mr. Mokretsov, FCS's Mr. Malinin and others. Representatives of the President's Administration and the Federal Security Service are also included on the Commission. There is not one single representative of the Ministry of Agriculture. They meet once every quarter and may invite for hearings representatives of Federal executive bodies.

Delving into several areas of regulation is the Decree (#1940-p) signed by Russian Prime Minister Putin on December 14, 2009 on “Measures to Increase the Effectiveness of Regulation of Alcohol Production in the Russian Federation and of Production of Ethyl Spirit” (the original text of the Decree can be found on the website at: http://admfmao.ru/committe/pal_liz/zakon/1940.htm). This Decree actually repeats most of the requirements of the so-called Presidential Alcohol Action Plan of September 11, 2009 (please see section GOR's Alcohol Strategy below) and was later elaborated by the FSRAM as a

result of GOR Meetings on alcohol in summer 2010. Few of these proposed measures have been adopted, to date. That said, below are the measures laid out in the Decree to increase the effectiveness of regulation of the alcohol market:

- amendments to the GOR Tax Code on changes to the system of levying of excise tax on ethyl spirits and alcohol products, including prepayment of excise tax by purchaser of ethyl spirit;
- amendments to the State Regulation Law setting:
 - further restrictions on retail sales of alcohol, including restrictions on time, place of sale and drinking age;
 - unified requirements for licensing of retail sales;
 - unified requirements for declarations of retail sales;
 - further details for purchasing, storing, using and reporting on stamps
- amendments to a number of Laws that will provide for strengthening of penalties for violations in the sphere of production and turnover of alcohol, including violations in the sphere of retail sales;
- amendments to the Law “On Restrictions on Retail Sales and Consumption of Beer”.

Also according to the 2009 Decree, technical regulations for beer and alcohol products should be drafted which would provide for:

- a definition of low alcohol products as products containing no more than 7% of added ethyl spirit;
- restrictions on volumes of cans/bottles for low alcohol products - 330ml max;
- placement of a health hazard warning the size of 20% of the total surface space of a bottle/can.

This last technical regulation, requiring a health warning label covering 20% of the total surface of the bottle/can, is seen by the industry as an important public policy tool but excessively costly. The requirement is currently pending.

The Decree also calls for drafting GOR Resolutions providing for:

- a definition of territories where sales of alcohol products are banned;
- details for time, place and conditions for retail sales of alcohol products;
- further details on functions on the Federal Service on Regulation of the Alcohol Market;
- further details on State Register of alcohol licenses;
- amendments to GOR Resolutions #785 on December 21, 2005 and #866 on December 31, 2005 on Federal Special and Excise Stamps, particularly on:
 - introduction of better protected Federal Special and Excise Stamps;
 - calculation of actual needs for stamps by organizations
- amendments to RF Government Resolution #320 on March 22, 1999 that provides for release from applying excise stamps on certain kinds of alcohol products

The pending technical regulations remain among the most unclear on the Duma’s legislative field in terms of their future. Currently there are at least three Draft Technical Regulations on Wine and Wine Products (only one of them submitted to the State Duma on behalf of a group of Duma Members), one Draft Technical Regulation on Beer (adopted by the State Duma in First Reading) and one Draft Technical Regulation on Alcohol Products, which encompasses regulations for wine and beer as well. It could take as long as a year to sort them out.

And, finally, the Decree is calling for reports to the Russian President on:

- a state policy to decrease alcohol abuse (this policy was published at the end of December, 2009, and the original text can be found on the GOR official website at: <http://www.government.ru/gov/results/8964/> and <http://www.government.ru/media/2010/1/13/27086/file/2128-p.doc>)
- the introduction of a state policy on production and turnover of alcohol products

(Note: In March 2010 the GOR states that there would be no State monopolization of the alcohol market.)

With respect to safety, the Federal Service for the Protection of Consumer Rights and Human Welfare of the Ministry of Health and Social Development, aka Rospotrebnadzor, is responsible for regulating the quality and safety of alcohol. FSRAM, which control the legality of production and turnover of the alcohol products and Rospotrebnadzor, which has the authority to control quality and safety of alcohol, have been ordered to draft so-called Administrative Regulations for Interaction in the Sphere of Control of Production and Turnover of Alcohol by January 1, 2011.

GOR's Alcohol Strategy

According to the State Statistics Service while 12.1 million liters of vodka was produced legally in 2008, 17 million liters were sold in stores. This suggests that the illegal vodka market totaled 28.8 percent of all sales. Industry experts estimate the percent of illegal vodka on the Russian market to be between 30 to 50 percent and according to various sources it is decreasing -- 47% in 2009, and 35% forecast for 2010. The percent of wine not made from grapes (a.k.a. "false wine") is 30%, cognac is 30%. The President, Federation Council, and various Ministries have proposed a steady stream of additional legislative initiatives on issues related to alcohol that are intended to cope with these and other problems.

On September 11, 2009 President Medvedev issued an order for a comprehensive government action plan to curb alcohol consumption. The order calls for strict penalties for sales of alcohol to minors, mandatory minimum wholesale and retail prices, consumer labeling requirements, health warnings, limits on advertising. The Concept was further elaborated by the FSRAM and provides for a number of wishful measures to be taken by the state so that by the year 2020 it can eradicate illicit alcohol production and decrease alcohol consumption and alcoholism in Russia. Specifically, the Government has set itself the ambitious goal of reducing the country's alcohol consumption, estimated by WHO at 10.32 litres per capita pure alcohol, by more than half over the next decade. National alcohol demand will be slashed in two phases: by 15 percent between 2010 and 2012 and by another 55 percent between 2013 and 2020. The Concept strategy explicitly targets the black market, saying the main hurdle to achieving its goal is eliminating illegal alcohol production, which will be a focus during the second phase.

Recently, initiatives to moderate drinking include a Moscow curfew on strong alcohol sales which bans the sales of beverages with over 15 percent alcohol content between 10:00 pm and 10:00 am. The ban went into effect on September 1, 2010. Many Russian regions supported the Moscow City initiative on retail sales time restrictions. Further, in October 2010 the Chairman of the Federation Council, Mr. Mironov, made a public statement saying that he will support the Draft Law to increase the legal drinking age in Russia from 18 to 21 years, which is currently being considered by the State Duma. Recently, the Ministry of Health has submitted a Draft Amendment to the Law on Advertising, which

basically bans all alcohol advertising except for beer, leaving the door just slightly open to advertisement in special industry editions. According to the Draft, advertising of alcohol products will be banned in all spheres except for specialized press and alcohol retail spots. The Draft also bans hand-outs of product samples if the alcohol content is above 15%.

In addition to creating FSRAM, the new plan led to creation of the GOR Commission on Regulation of the Alcohol Market (please see above).

Price Regulation

FSRAM regulates minimum prices for alcohol in Russia. FSRAM has set the minimum retail price for a half liter bottle of vodka or vodka product (both local and imported) at 89 rubles as of January 1, 2010 (the prices for all other volumes in retail are to be calculated and set accordingly). The original text of the Resolution Order #17n can be found on the Russian government's official newspaper site at <http://www.rg.ru/2009/12/16/alko-dok.html>.

The minimum price includes production costs of 16 rubles, excise tax per half liter of 38.2 rubles, VAT of 18 percent equivalent to roughly 10 rubles, minimal wholesale margin of 10 percent and minimum retail trading margin of 20 percent. Alcohol industry players think that the function of minimum price setting for alcoholic beverages is very important because it helps contain the black market. In 2009, it was possible for consumers to buy a half-liter of illegal vodka for 35 to 70 rubles, while the same product would cost at least 89 rubles if all excise fees were paid. The new minimum prices of 98 rubles for a half liter bottle of vodka or vodka product will be set as of January 1, 2011.

The minimum price for half-liter bottles of hard liquor over 28% abv as of June 1, 2010 is 65 rubles. And for ethyl spirits as of August 1, 2010 is 59 rubles per one liter. FSRAM also adopted an Order that introduces minimum prices for brandies: 190 rubles at retail, 165 rubles at wholesale and 150 rubles in production. The minimum prices for brandies are to be introduced as of January 1, 2011.

Excise Taxes

Excise tax rates for alcoholic beverages for the years 2010-2012 are increasing dramatically. In 2010, excise taxes on spirits of more than 9 percent ethyl alcohol are assessed at 210 rubles per liter of ethyl alcohol content (up 10%), whereas spirits of 9 percent and less are assessed at 158 rubles per liter – up by 30.5% from 2009. Table wine is up by 34.6% and assessed at 3.5 rubles per liter, sparkling wines up 33.3% in 2010 at 14 rubles per liter, and beer with 8.6 percent or less ethyl alcohol is the most dramatic with a 300% increase in excise rate to 9 rubles per liter.

Excise Tax Rates

	2009	2010	Preliminary 2011	% change , 2010/2009
Product	Rubles per liter	Rubles per liter	Rubles per liter of	

	of ethyl alcohol content	of ethyl alcohol content	ethyl alcohol content	
Spirits of more than 9 percent ethyl alcohol	191	210	231	9.9
Spirits of 9 percent and less	121	158	190	30.5
Table wine	2.6	3.5	4.8	34.6
Sparkling wine	10.5	14	18	33.3
Beer with 8.6 percent or less ethyl alcohol	3	9	10	300

NB: “Preliminary 2011” is the tax rates which were approved at the end of November 2009. These will likely be revised when the Federal Council approves the new rates at the end of November 2010.

The amendments also change the payment schedule for excise payments. Currently importers and domestic brewers and distillers make excise tax payments biweekly, but under the new rule a single payment would be made and due by the 25th of the month following the taxation period. (Business is encouraged to check the excise tax rates as they are typically revised at the end of the year.) According to Ministry of Finance data, alcohol sales bring a total of only 0.85 percent of all RF Federal Budget annual revenues.

For 2011 rates, excise taxation of alcohol will increase by 10-37% depending on the product. According to the amended Excise Chapter domestic producers will have to pay excise tax in full at purchase of ethyl spirit.

Import License

At the end of November, 2009 the leaders of Russia, Belarus and Kazakhstan signed a packet of documents to create a Trilateral Customs Union (TCU) for which most provisions took effect January 1, 2010. As part of the TCU the TCU Customs Code was signed as well as documents on Unified Customs Tariff Regulations, on Information System for the Purpose of Foreign and Mutual Trade and on Creation of a Unified Economic Space. The original text of the TCU Resolution and other TCU documents can be found on the Trilateral Customs Union’s official website at:

http://www.tsouz.ru/Docs/IntAgrmnts/Pages/Perechen_MDTs.aspx

The most import effect for U.S. alcohol exporters is that as of January 1, 2010 importers of each category of alcohol (wine and spirits) must have an import license issued by the Ministry of Industry and Trade. Previously, this license was known as the “white spirits” license and was required only for vodka, rum, tequila, and gin. Importers may obtain a general import license valid for one year (Resolution #261 on April 2010 “On issue general license of ethyl spirits and alcohol production import”: <http://government.ru/gov/results/10375/>).

Despite the notion that the Customs Union will allow for the free flow of trade among the member countries, the Russian Federal Customs Service has clarified that imports will proceed in accordance with the requirements of the State Regulation Law and there will be no free movement of alcohol products from CU territories; sales of alcohol products in Russia will only be allowed if properly marked with Russian excise stamps; and customs clearance of alcohol imports to Russia may only be done on Russian territory with all respective customs regulations applied. Details about the TCU activity can be found in several U.S. Department of Agriculture Attaché (a.k.a. GAIN) reports at <http://gain.fas.usda.gov/Lists/Advanced%20Search/AllItems.aspx>

Certification and Technical Standards

Beginning in February 2010, Russia began to replace its mandatory quality certification system with a system of self-declaration of conformity. The move is intended to ease the bureaucratic burden on business and to allow producers to vouch for their goods based on their own verification. However, the new declaration requirements are stricter than under the previous certification system. Details about the replacement of mandatory certification of quality system with a system of self-declaration of conformity can be found in GAIN Declaration of Conformity Replaces Certification for Many Products (03/25/10).

Industry Initiatives

Due to the complex and unpredictable nature of local alcohol regulations, the industry is joining together by forming industry groups where they can share information and strategize.

An Association of Wine Importers (AWI) was established on October 7, 2010 in Moscow made up of the nine major wine importers (27% of Russian wine market sales) and with the endorsement of Federation Council Member, Mr. Pochinok (who is also author of an alternative wine Technical Regulation (TR) currently under consideration in the Federation Council). AWI has already announced that it will focus on work on the Draft Technical Regulations for Wine and on the customs-tariff policy towards wine and wine products.

On October 20, 2010 the Association of Producers of Sparkling Wines (APSW) was created. APSW unites major Russian producers of sparkling and 'champagne' style wines. The objectives of APSW are to represent association members and to defend their interests in the state and public structures. The Association's priority is counteracting illegal sales of 'champagne' style wine. APSW maintains that the price for 'champagne' could not be less than 120 rubles per bottle, but in retail you can find it for much less and thus foul play is suspected.

The Alcoholic Beverages Committee (ABC) is a longstanding non-commercial partnership created by a group of leading alcohol producing companies and importers. Among the main issues ABC is discussing is how to address the strict requirements being imposed by FSRAM to obtain or renew wholesale licenses. FSRAM reportedly has a long list of documents and requirements necessary for obtaining a five-year wholesale license, which is required for importers not only to run a warehouse and wholesale operations in Russia but also to acquire excise stamps: a valid wholesale license must be presented at the RF Customs when applying for excise stamps.